

SELECTED AREAS OF COST

Chapter 24 – Employee Welfare and Morale Expense

Authoritative Sources

[FAR 31.205-13](#) Employee Morale, Health, Welfare, Food Service, and Dormitory Costs and Credits

[FAR 31.205-14](#) Entertainment Costs

Employee welfare and morale expenses are costs incurred on activities to improve working conditions, employer-employee relations, employee morale, and employee performance. Expenses and income generated by employee welfare and morale activities should be reviewed for compliance with FAR 31.205-13. Note that employee morale type expenses are often covered by the entertainment cost principle, 31.205-14. FAC 90-31, effective October 1, 1995, clarified that entertainment costs are not allowable under any other cost principle. By statute, entertainment costs are expressly unallowable, without exception. Consequently, the entertainment cost principle at FAR 31.205-14 takes precedence over any other cost principle.

This chapter addresses the following topics:

- 24-1 General
- 24-2 Employee Associations
- 24-3 Major Property Acquisitions for Employee Welfare Purposes
- 24-4 Gifts, Recreation, and Entertainment

24-1 General

Aggregate costs incurred for employee welfare and morale, less credits for income generated by these activities, are allowable except as noted in paragraphs b. through e. below, to the extent that the net amount is reasonable. In applying the provisions of FAR 31.201-3, Reasonableness, the auditor should consider whether the expenditure is reasonable in nature and amount both for the contractor as a whole and for the employee(s) benefited by the expenditure.

Costs relating to welfare and morale activities, if significant, should be subjected to the test of reasonableness as to purpose and amount (also see Chapter 1, Advertising and Public Relations). When reasonableness as to purpose has been established, reasonableness of amount should ordinarily be applied to overall amounts and not to individual items of cost, provided the items are not made specifically unallowable by FAR Part 31.

24-2 Employee Associations

If a contractor has an arrangement permitting an employee association to retain the income from vending machines, such income should be considered in evaluating the total cost of the employee welfare and morale program as if the contractor received the income (FAR 31.205-13(e) and (f)). The auditor should examine the records of the employee association to ascertain that the income was reasonably expended for the purposes intended and that there is no undue accumulation of unspent funds. Any such accumulation should accrue to the Government by treating it as a deduction from otherwise allowable overhead.

In some instances, employee associations may use the vending machine income for the purchase of recreational and other employee welfare tangible personal or real property, or the employee association may purchase assets by means of a loan or mortgage. Allowable costs on capital assets thus purchased are limited to the equivalent amount of costs that would be allowable if the contractor had acquired the property and incurred the costs directly (FAR 31.205-13(f)). Accordingly, allowable costs will normally be restricted to ownership costs such as depreciation, insurance, taxes, etc. The total expenditure for property should not be allowed as a cost in the year of purchase, except where the property involved is of the type that would be expensed under the contractor's normal accounting practices.

24-3 Major Property Acquisitions for Employee Welfare Purposes

The reasonableness of major property acquisitions for employee welfare purposes is necessarily a matter of some significance. The auditor should review such purchases to determine whether:

1. they are reasonable under the criteria set forth in FAR 31.201-3 and
2. costs resulting therefrom are properly allocable to Government contracts.

If the assets acquired are not of a type generally recognized as ordinary and necessary for purposes of employee welfare and morale, the related costs may be considered unreasonable and, therefore, not acceptable. A situation fitting this category would be when the acquisition benefits only a limited number, or certain classes, of employees. As a further consideration, real property donated or acquired from contributions made by the contractor should be carefully scrutinized, as it would seldom be reasonable for the contractor to give the property to its employee organization. Doing so would not as a rule give the employee association any benefit from the use of the property that it would not enjoy had the contractor retained title. By retaining title the contractor would keep a valuable asset which could be converted to other use or sold when it is no longer needed for its original purpose.

24-4 Cafeteria Losses

The costs of cafeteria operations should include all indirect expenses pertaining to these services, as required by the full absorption cost methods prescribed by CAS 418. Auditors will verify that an allocable share of occupancy costs is included in the calculation of the total costs of cafeteria operations.

Losses from operating cafeterias may be included as costs only if the contractor's objective is to operate such services on a break-even basis. One factor to consider is whether the prices charged are comparable to those available in commercial establishments. Losses sustained because these services are furnished without charge or at unreasonably low prices obviously would not be conducive to the accomplishment of the above objective and are not allowable. However, a loss may be allowable, provided the contractor can demonstrate that unusual circumstances exist such that even with efficient management, operating the service on a break-even basis would require charging inordinately high prices, or prices higher than those charged by commercial establishments. Examples of unusual circumstances are:

(a) adequate commercial facilities are not available, or

(b) reasonable prices are a necessary incentive to keep employees onsite to avoid the more significant costs of lost productive time due to longer lunch periods if the services were not provided.

When cafeteria losses are claimed by the contractor, it is the contractor's responsibility to demonstrate that unusual circumstances exist and to provide supporting documentation such as price comparisons with similar commercial establishments, or the distance of restaurants. The auditor should determine the validity of the contractor's justifications on a case-by-case basis. If the contractor fails to provide adequate documentation justifying the allowability of such losses, the auditor should question the costs.

24-5 Gifts, Recreation, and Entertainment

For contracts issued on or after January 13, 1995, costs of gifts, recreation, and entertainment incurred subsequent to September 30, 1995 were made specifically unallowable, with a few exceptions (see FAC 90-31).

Although gifts are an expressly unallowable expense, the cost principle specifically excludes two categories of awards from the unallowable gift definition:

- a. Awards covered by the compensation cost principle at 31.205-6; and
- b. Awards made pursuant to an established plan or policy for recognition of employee achievements.

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Recreation expenses are an expressly unallowable expense with the following exception: Costs of employees' participation in company sponsored sports teams or employee organizations designed to improve company loyalty, team work, or physical fitness. The exception does not allow general recreation activities and does not allow any costs disallowed by FAR 31.205-14, Entertainment. If the Government challenges the allowability of claimed recreation costs, it is the contractor's responsibility to establish that the cost claimed meets the following criteria:

- a. The cost is for employee participation in a sports team or employee organization.
- b. The team or organization is company sponsored.
- c. The team's or organization's activity is designed to improve company loyalty, team work, or physical fitness.

Entertainment costs are expressly unallowable, without exception. Therefore, even if the principal purpose for incurring an entertainment cost is other than for entertainment, the entertainment cost is unallowable. For example, while the cost of a contractor open house for employee families is generally allowable, the cost of entertainment provided as part of the open house is unallowable.

Taken together, the statute and the cost principles at 31.205-13, Employee morale, and 31.205-14, Entertainment, expressly disallow costs which some contractors may have considered reasonable and allowable prior to the effective date of the current rule, October 1, 1995. Examples of such costs include, but are not limited to:

- a. Entertainment provided as part of public relations, employee relations, or corporate celebrations;
- b. Gifts to anyone who is not an employee;
- c. Gifts to employees which are not for performance or achievement or are not made according to an established plan or policy;
- d. Compensation awards of entertainment, including tickets to shows or sports events, or travel; and
- e. Recreational trips, shows, picnics, or parties.